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Benjamin Witte-Lebhar

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Government Promises More Social Spending as Tax Reform Takes Effect in El Salvador

by Benjamin Witte-Lebhar
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Despite an avalanche of objections from the country’s business associations, conservative press outlets, and far-right political opposition, recently inaugurated Salvadoran President Salvador Sánchez Cerén has managed to push through a tax-reform package that targets wealthy contributors and carries the promise of a boost in social spending.

The new policies, which went into effect Sept. 1, introduce a minimum 1% tax on net assets for companies with annual sales of at least US$150,000 and a 0.25% tax on bank transactions (including money transfers and payments made with checks or credit cards) involving US$1,000 or more. The reforms also did away with an income-tax exemption that Salvadoran newspaper owners had enjoyed since 1950. The Sánchez Cerén administration expects the measures will together boost government coffers to the tune of US$160 million annually.

In addition, the government now has the authority to divulge the names of companies that refuse to settle delinquent tax debts. Sánchez Cerén, a former guerrilla commander who hails from the left-wing Frente Farabundo Martí para la Liberación Nacional (FMLN), has said he will introduce further legislation giving those companies a 90-day grace period and exempting them from whatever fines and interest they have accrued. After that, however, the government expects all debts to be honored.

"It’s like an act of good will toward the companies, so that they can free themselves from the millions of dollars worth of pressure and pay the state," the president said during a public appearance Aug. 23 in La Chacra, an impoverished community on the outskirts of San Salvador. "What the state cannot forgive is the capital debt, but we are going to forgive fines and accumulated interest."

The Asamblea Legislativa (AL), El Salvador’s 84-seat unicameral parliament, approved the measures three weeks earlier in a controversial late-night session during which the leading opposition party, the hard-right Alianza Republicana Nacionalista (ARENA), walked out in protest—before the vote was held. The Partido de Concertación Nacional (PCN) and Partido Demócrata Cristiano (PDC), which have eight deputies between them, also abstained. Lawmakers from the FMLN and Gran Alianza para la Unidad Nacional (GANA), a conservative party formed several years ago by ARENA dissidents, decided to push through with the session regardless and, together with three deputies from minority factions, passed the new tax rules with just 44 votes cast.

"It’s clear that the banks and large companies are the ones who will pay. The additional funds are so that we can have health care, education, and security. Above all it’s for the common good, not just for the well-being of a few," said GANA Deputy Guillermo Gallegos.

The cascade effect
But while the reforms may be good news for the regular citizens expected to benefit from increased government social spending, they have spelled trouble for the president’s already uneasy
relationship with ARENA and its allies in the country’s leading business associations. Sánchez Cerén won the presidency this past March after a long and bitter campaign battle against ARENA candidate Norman Quijano, a former San Salvador mayor. The FMLN veteran beat Quijano by fewer than 6,400 votes (NotiCen, March 20, 2014).

Groups such as the Asociación Nacional de la Empresa Privada (ANEP), the Fundación Nacional para el Desarrollo (FUNDE), the Cámara de Comercio e Industrial de El Salvador (CCIES), and the Asociación Bancaria Salvadoreña (ABANSA) have all gone to great lengths to discredit the measures, saying the new taxes will have a "cascade effect" and ultimately hurt the people they were designed to help: the poor. The changes, they argue, will hamper investment and thus hurt the overall economy, which grew just 1.7% last year, according to the World Bank. Jobs will be lost, the business groups claim. Prices will rise. Consumers will suffer.

"Last night we went to sleep in an El Salvador with limited possibilities. Today we wake up in a country that’s even worse off," ANEP president Jorge Daboub told reporters shortly after the July 31 AL vote.

A month later, one of ANEP’s member associations, the Sociedad de Comerciantes e Industriales Salvadoreños (SCIS), filed a suit against the new tax laws before the Corte Suprema de Justicia (CSJ). The CCIES has promised to do the same. "We’re on the threshold of a serious economic crisis and a downturn in foreign investment," CCIES head Luis Cardenal warned during an Aug. 19 presentation.

The right-wing press has campaigned against the new tax laws as well. In an editorial published Aug. 27, El Diario de Hoy warned that the "avalanche of taxes that are being decreed undermines the ability of producers to generate wealth and jobs." The new taxes hurt individual families too, the conservative daily argued. The 0.25% bank-transaction tax, for example, does not affect just the rich, it means that a husband who writes his wife a check to cover grocery bills will also have to pay, "even though they’re in the same family," the editorial explained.

"Pitfalls of power"

Backers of the tax-reform package dismiss the "cascade effect" talk as both alarmist and inaccurate. The economy, they argue, is not going to be crippled by clearer rules regarding business taxes or by a minor banking-transaction tax, especially given all the exceptions written into the law. Despite widely repeated claims to the contrary, the transaction tax does not, for example, apply to remittances sent from abroad, members of the Sánchez Cerén administration have pointed out. Nor does it apply to regular ATM withdrawals, social security payments, or loan repayments. There is an exception as well for small-business owners.

"These taxes are directed at large transactions. They’re not going to affect people with low incomes. What’s been suggested [by critics] isn’t true. They’re just arguments to justify why they don’t want to support this reform," the president told supporters Aug 1. "I don’t know why some business owners don’t like to pay taxes."

More problematic for the Sánchez Cerén administration are complaints—and not just from the far right—regarding the manner in which the measures were approved. In a recent editorial, the independent news portal El Faro defended the tax reform as "not only necessary, but just." The article went on to say, however, that the FMLN ended up "staining" the initiative by using a
backroom deal with GANA to rush the bill through the AL and thus deny the far right additional time to debate. The governing party bypassed "all the established procedures" in a way that was "not only politically arrogant but disrespectful toward the citizens and contemptuous of democracy," El Faro opined.

GANA, numerous news outlets surmised, agreed to back Sánchez Cerén’s tax reform in exchange for FMLN support in a separate vote regarding the next head of the Corte de Cuentas de la República (CCR), an audits court responsible for overseeing all government spending. GANA’s preferred candidate, Johel Humberto Valiente, ended up winning the coveted post in an AL vote that took place Aug. 1, just one day after the tax legislation passed. "Unfortunately, with this act, the ex-guerrilla seems to have again been seduced by the pitfalls of power," El Faro wrote.

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